INDEX

for certiorari was filed on June 1, 1964, and was granted on October 12, 1964 (R. 257). In No. 237, the time for petitioning for a writ of certiorari was extended by order of the Chief Justice to July 15, 1964 (R. 257); the petition was filed on July 1, 1964; and certiorari was granted on October 26, 1964 (R. 258). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether contract miners of coal who have no legally enforceable right to receive anything more than the value of their services for delivering coal to the lessee of mineral rights have a depletable capital interest in the mineral deposit.

STATUTE INVOLVED

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):

> SEC. 611. ALLOWANCE OF DEDUCTION FOR DEPLETION.
>
> (a) *General Rule.*—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. * * *
>
> (b) *Special Rules.*—
>
> (1) *Leases.*—In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.
>
> * * * * *

SEC. 613. PERCENTAGE DEPLETION.

(a) *General Rule.*—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. * * *

(b) *Percentage Depletion Rates.*—The mines, wells, and other natural deposits, and the percentages referred to in subsection (a) are as follows:

* * * * *

(4) 10 percent—asbestos (if paragraph (2)(B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

* * * * *

(c) *Definition of Gross Income from Property.*—For purposes of this section—

(1) *Gross income from the property.*—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

* * * * *

SEC. 614. DEFINITIONS OF PROPERTY.

(a) *General Rule.*—For the purpose of computing the depletion allowance in the case of mines, wells, and other natural deposits, the term "property" means each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land.

* * * * *

STATEMENT

These cases involve deficiencies in income tax for the years 1954–57 asserted by the Commissioner of Internal Revenue against Paragon Jewel Coal Company, the lessee of coal bearing lands, and against the contract miners who extracted the coal on those lands. The deficiency in each case arose from the denial of a claimed percentage depletion deduction. The parties agree that either Paragon or the contract miners—but not both—are entitled to the contested percentage depletion deduction. The Commissioner's position, here as in the court below, is that Paragon (petitioner in No. 134) is entitled to the deduction and that the contract miners (respondents in No. 237) are not. The two cases were consolidated in the courts below and have been consolidated here by order of the Court (R. 258).

1. The contract miners[1] were members of partnerships which entered into oral agreements with the lessee of coal lands to mine the coal and deliver it to the lessee's tipple.[2] A representative of Paragon and the prospective miner would choose a location on the out-

[1] The respondents' wives are parties in No. 237 only because they filed joint income tax returns with their husbands. (R. 192–193.)

[2] Paragon was actually a sub-lessee or assignee of the leases (R. 211), a fact with no significance here. Its written leases on Virginia coal tracts required it to mine at least 85 percent of the merchantable coal in the tracts and to pay minimum annual royalties, tonnage royalties, and land taxes. The contract miners did not assume any of Paragon's obligations under its leases and they paid no royalties or taxes on the property or the mineral interest. (R. 213–214.)

crop and the representative would indicate, on a map or on the surface of the ground, the general area and direction in which the contract miner could mine. At his own expense and with his own men and equipment, the miner would mine the coal by driving entries into the hill from a point on the outcrop, bring the severed coal to the surface, load it on trucks, and deliver it to Paragon's tipple. Paragon then cleaned and sized the coal and sold it on the open market. (R. 193–205, 211–212.)

The contract miners were obligated to deliver any coal they mined to Paragon; they could not take it elsewhere. Paragon set and changed at will the amount it offered to pay the miners for each ton of coal mined and delivered. The contract miners were normally given several days notice of any change in the price that would be paid for coal delivered at Paragon's tipple. In fact, Paragon changed the price on some nine occasions in a six-year period encompassing the taxable years involved here. Paragon made those changes either to induce the miners to continue to mine when it appeared that they were unable to make a profit, to keep step with union wage increases paid by Paragon's competitors, or when Paragon's profit margin diminished as a result of a general downward trend in prices. The contract miners had no interest in the proceeds of the sale of the coal. Their right to payment did not depend upon the existence of sales proceeds and the amount of payment did not vary with the daily fluctuation in the market prices of coal. (R. 95–96, 119–120, 169, 186, 214, 216, 230.)

The agreements were not for a definite term. On the contrary, the contract miners were free to quit at any time if they found they could not mine profitably, and a number did cease mining from time to time. The agreements did not obligate the contract miners to mine a specific area of coal to exhaustion, nor were they specifically given a right to mine any particular area to exhaustion. However, it was anticipated by both parties that a contract miner would continue mining in the location assigned to him as long as he could mine coal profitably and as long as he employed proper mining methods in extracting the merchantable coal. Several of the respondents paid other contract miners to be permitted to succeed them in the operation of existing mines. In one instance, $3,500 was paid, added to depreciable assets and written off over a two-year period. In another instance, $21,000 was paid for equipment and mining rights, allocated to equipment, and depreciated. (R. 173, 212–213.)

2. Paragon claimed percentage depletion based on the amounts it received for selling the coal in the open market (less royalties paid to lessors and sublessors). (R. 192, 216–217.) Some of the contract miners claimed percentage depletion based on the amounts they received from Paragon for mining and delivering the coal. (R. 217.) The Commissioner of Internal Revenue determined that the contract miners, through their partnerships, were not entitled to any percentage depletion deduction. In order to protect

the revenue should the miners prevail, he also determined that Paragon was required to diminish its percentage depletion base in each year by the amount it paid to the contract miners. (R. 217.) Deficiencies were determined accordingly. (R. 5–11, 22–28, 192, 216–217.)

The Tax Court held that Paragon, and not the contract miners, was entitled to the contested portion of the depletion deduction (R. 217–225) because the contract miners "made no investment in and acquired no economic interest in the coal in place" (R. 224). In reaching that result it found that the contractors "acquired no legal title either to the coal in place or to the coal after it was mined." They "sold none of the coal to anyone other than Paragon and were not entitled to do so." Paragon "paid the contractors the prices fixed by Paragon" (R. 216), and the amount so paid "was apparently changeable at the will of Paragon" (R. 222).

On review, the court of appeals reversed (R. 252–255). Overturning a finding of the Tax Court that the oral contracts were terminable at will by Paragon, the Fourth Circuit found that "the operator had a continuing right to produce the coal and to be paid therefor at a price which was closely related to the market price" (R. 255). This, the court held, resulted in a depletable economic interest in the minerals.

759-917—65——2

ARGUMENT

PARAGON, AND NOT THE CONTRACT MINERS, IS ENTITLED TO THE PERCENTAGE DEPLETION DEDUCTION, FOR THE CONTRACT MINERS DID NOT HAVE A CAPITAL OR ECONOMIC INTEREST IN THE UNMINED MINERAL DEPOSIT

Introduction

In the case of coal, Sections 611 and 613 of the Internal Revenue Code of 1954 authorize a percentage depletion deduction in an amount equal to 10 percent of the "gross income from mining." The deduction is intended to allow a taxpayer to recover the capital value of a mineral in place which is diminished by extraction and sale of the mineral. This is accomplished by treating a statutorily prescribed percentage of the proceeds of sale of the mineral as a return of the taxpayer's capital interest in the unmined deposit. While there may be more than one depletable interest in the same deposit, the total amount of the depletion deduction is a constant, a specified part of the "gross income from mining" the deposit. Accordingly, the deduction must be parcelled among whichever taxpayers have a depletable interest in the deposit.

The present case involves conflicting claims of taxpayers competing for a portion of the percentage depletion allowance arising from the sale of coal extracted by contract miners from a lessee's mineral leases. Specifically, the question is whether the lessee of the coal lands is entitled to percentage depletion on all the gross income derived from the sale of the coal mined from the leases, or whether the contract

miners who do the mining acquired a depletable interest to the extent they were paid by the lessee for mining and delivering coal to it. We believe it plain, on the facts of this case, that Paragon, the lessee, is entitled to the contested depletion allowance because it owned a valuable but wasting interest in the mineral deposit and the miners did not.

"The purpose of the deduction for depletion is plain and has been many times declared by this Court. 'It is permitted in recognition of the fact that the mineral deposits are wasting assets and is intended as compensation to the owner for the part used up in production.' *Helvering* v. *Bankline Oil Co.,* 303 U.S. 362, 366." *Parsons* v. *Smith,* 359 U.S. 215, 220. Accordingly, the deduction is available only to the owner of a capital interest in the mineral deposit. *Burton-Sutton Oil Company* v. *Commissioner,* 328 U.S. 25. The legal form of such a capital interest is unimportant; it is sufficient if the taxpayer owns what this Court has called an "economic interest" so long as this ownership interest constitutes a capital asset, a right with regard to the mineral in place, which is depleted as the deposit is mined and sold. *Burnet* v. *Harmel,* 287 U.S. 103; *Palmer* v. *Bender,* 287 U.S. 551. But at a minimum, the taxpayer must have a legally enforceable right to share in the value of the unmined mineral deposit, whether by receipt of part of the mineral itself or by sharing in the proceeds of its sale. *Palmer* v. *Bender,* 287 U.S. 551. Without such a right, the taxpayer has no capital

interest in the deposit which could be exhausted by production and sale of the mineral.

A contract miner has no capital interest in a mineral deposit—*i.e.*, no enforceable right to share in the value of that deposit—if his right to payment for delivering the coal he mines is subject either to the leesee's power to terminate the contract at will or to the lessee's power to pay the miner only the value of the services he actually performs. In the first case, the contract miner has no capital interest in the coal, for he can be cut off from any payments whatsoever at the will of the lessee. That is obviously inconsistent with the existence of a legally enforceable right in the deposit itself. The second case is equally clear. If the lessee can reduce the price the contract miner will be paid for mining and delivering the coal to the value of the miner's services with the miner's only recourse being to withdraw from the job, the miner has no legally enforceable right to share in any value of the unmined mineral deposit. He can demand payment only for the value of his services, for if he refuses to work unless paid more, the lessee can substitute another contractor to perform the services.

It is plain, on the facts of this case, that Paragon, the lessee, had and exercised the right to set and reset the price the contract miners were paid for mining the coal and was at most obligated to pay only the value of the services actually rendered. The miners, therefore, had no legally enforceable right to share in the value of the mineral deposit and, thus,

no capital interest in that deposit which was exhausted with the mining and sale of coal.

I

ONLY A TAXPAYER WITH A LEGALLY ENFORCEABLE RIGHT TO SHARE IN THE VALUE OF A MINERAL DEPOSIT HAS A DEPLETABLE CAPITAL OR ECONOMIC INTEREST IN THAT DEPOSIT

Section 611 of the Internal Revenue Code of 1954 directs that a reasonable allowance for depletion shall be made "[i]n the case of mines * * * according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations to be prescribed by the Secretary"; and that "[i]n the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee." Section 613 provides that the allowance for coal shall be 10 percent "of the gross income from [mining][3] the property [during the taxable year] excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property".

The percentage depletion deduction is intended to allow tax-free recovery of the capital value of a mineral deposit by deducting from gross income that part of the proceeds of sale of the mineral which Congress has determined represents the value of the wasting asset in the ground. Since, as this Court has repeatedly recognized, the deduction is meant to recognize

[3] Section 613(c)(1) provides that the "term 'gross income from the property' means, in the case of a property other than an oil and gas well, the gross income from mining."

for tax purposes the loss of capital to a taxpayer as he progressively mines and sells a wasting asset, the deduction is premised on the existence of a capital interest owned by the taxpayer in the mineral deposit—an interest which diminishes in value as a result of the deposit's exhaustion through extraction and sale of the mineral. The depletion "exclusion is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." *Commissioner* v. *Southwest Exploration Co.*, 350 U.S. 308, 312. See, also, *Parsons* v. *Smith*, 359 U.S. 215, 220; *United States* v. *Ludey*, 274 U.S. 295, 302; *Anderson* v. *Helvering*, 310 U.S. 404, 408; *Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599, 603.

Because the statute deals with economic realities, not legal forms, a taxpayer need not have any particular form of legal title to the mineral deposit to be entitled to share in the depletion deduction. But he must have, at a minimum, a legally enforceable right to share in the value of the mineral deposit, either by sharing in the mineral itself or in the realization of its value by sale. For if he has no such legally enforceable right, the taxpayer has no capital or economic interest in the deposit which is reduced in value by the extraction and sale of the mineral. Since the percentage depletion deduction is granted to compensate for the reduction in value of a taxpayer's capital assets caused by mining a mineral deposit, it is available only to a taxpayer who has an enforceable right to share in the value of the deposit and thus whose capital assets are reduced by mining.

II

A CONTRACT MINER HAS NO LEGALLY ENFORCEABLE RIGHT TO SHARE IN THE VALUE OF A MINERAL DEPOSIT IF EITHER (1) THE AMOUNT HE IS TO BE PAID CAN BE REDUCED AT THE WILL OF THE LESSEE TO THE VALUE OF THE MINING SERVICES OR (2) THE CONTRACTOR'S RIGHT TO MINE CAN BE TERMINATED AT WILL BY THE LESSEE

1. A contract miner who is required to deliver the mined coal to the lessee at whatever price the lessee chooses to post from time to time obviously has no capital or economic interest in the value of the mineral deposit even though he has a right to continue to mine the deposit so long as he is willing to do so at the posted prices. Being legally free to set the tipple price at whatever level it chooses, the lessee need pay the miner only whatever amount is necessary to induce the miner to continue to mine and may thus keep for itself the whole value of the mineral deposit in place. Whether the value of the deposit be small or great, the miner receives only what he is able to command for his services and it is the lessee, and the lessee alone, who realizes upon the value of the mineral in place.

It is true, of course, that economic forces will constrain the lessee's exercise of his legal freedom to set the tipple price: if it wishes to stay in business, the lessee must pay the miners enough to keep them working. If business is bad, the miners may be willing to accept less in order to keep their jobs. If business is good, they will ask for more and—depending on their economic bargaining power or the lessee's "enlightenment"—may be able to get it. Economic forces

will thus cause the tipple price to move, not only with wage rates in the area, but also, at least to a degree, with the market price of coal. The forces producing that result, however, are no different from those entering into the determination of wages in any industry. The fact that increased profits in the automobile industry enhance the bargaining position of the employees and may enable them to obtain a wage increase does not give automobile workers a depreciable interest in their employer's equipment. No more does the fact that economic forces may cause a coal lessee to increase the tipple price when the market price for coal increases give contract miners a depletable interest in the coal deposit. All the miners have to sell is their services, and what they receive is only what, under the economic conditions existing from time to time, they are able to command for those services. The costs of extraction—*i.e.*, what the lessee must pay the miners to induce them to continue mining—will of course affect the value of the deposit in the ground, but, whatever that value is, it will redound to the benefit only of the lessee. The contract miners have no greater or different right to share in the value of the deposit than do the office personnel employed by the lessee, who likewise may be able to demand higher salaries when business is good.

The fact that a contract miner has no legal interest in the mineral in place does not, of course, mean that he suffers no loss when the mineral is exhausted. When the deposit is exhausted, he will be out of a job, and it

may be that he will be unable to find another as advantageous. But that loss is no different from that of a lawyer when a client dies or that of an employee when the plant burns down. The loss is merely from the termination of an advantageous business relationship, not the exhaustion of a capital interest in the mineral deposit itself. The reason, again, is that the contract miner is entitled to receive only what he can command for his services. Whatever the owner of a mineral deposit is able to command by virtue of his ownership accrues only to the lessee, and it is only the latter who has a right to share in the value of the mineral in place.

2. We have thus far considered the case in which, while the contract miner is entitled to continue to mine the deposit so long as he wishes to do so, the lessee is free of any legal restraints in setting or changing the tipple price. The result would be no different, however, if the lessee were legally bound to pay the contract miners the reasonable value of their services in the light of the labor and market conditions existing from time to time—an agreement which might, for example, provide for arbitration should the parties be unable to agree. Such a right would merely substitute legal remedies for economic bargaining power to determine the amount to be paid the miners for their services. So long as the standard by which the tipple price is to be determined is the value of the miners' services in mining the coal—with the market price of coal being relevant only to the extent that ability to pay is normally relevant to wage determinations—the sub-

stitution only makes explicit what is implicit in relying on economic forces to determine the tipple price: that the contract miners, furnishing only services, have a right (or power) to demand only what their services are worth. The miners would still have no right to share in the value of the mineral deposit. The lessee need offer them only the value of their services, and if the contract miners refuse to mine at the offered price, the lessee may substitute other contractors to do the mining, thus still retaining for itself the full value of the unmined mineral deposit. Under such a contract, in short, the contract miner has only a right to be paid the fair value of his services, not a right to share in the value of the mineral in place, and the capital interest in the mineral deposit—and the benefit of any increase in its value or in the ultimate sale price of the coal—is retained in full by the lessee.

3. Similarly, a contract miner has no capital or economic interest in the value of a mineral deposit, whatever the price terms, if the lessee has the power to terminate the contract at will. It is, of course, a commonplace that one does not own what can be taken away by another with impunity. That is no less true of mineral deposits than of other assets. A mining contractor does not have a capital or economic interest in unmined coal if he has no right to demand part of the value of that deposit, and he has no enforceable right to share in its value if the lessee is entitled to terminate the miner's interest whenever the miner is demanding or receiving more than the value of his mining services. In short, a contract

miner whose contract is terminable at the will of the lessee has no asset of any value in respect of the mineral deposit, for he has no power to tap the resource without the continuing consent of the lessee.

III

THE CONTRACT MINERS IN THIS CASE HAD NO CAPITAL OR ECONOMIC INTEREST IN THE UNMINED COAL BECAUSE PARAGON COULD, AT ANY TIME, REDUCE THE PRICE PAID FOR DELIVERY OF MINED COAL TO THE VALUE OF THE MINERS' SERVICES ALONE

We have shown that the existence of a power in the lessee *either* to terminate the contract at will *or* to reduce the amount paid for delivering coal to the value of the miner's services precludes any contention that a contract miner has a depletable capital interest in the mineral deposit in place. We believe it is unnecessary to analyze the oral contracts in this case to determine whether they were terminable at the will of Paragon as the Tax Court held, for the fact that Paragon at all times retained the right to reduce the amount paid the miners to the value of their services is plain on the record and the findings of the Tax Court and is uncontradicted by the court below.

1. The Tax Court found that the contractors had no right to dispose of coal they had mined. They could deliver only to Paragon at prices set by Paragon. Their bargaining power arose solely from their right to refuse to furnish the necessary mining services. Thus, the contractors "acquired no legal title either to the coal in place or to the coal after it was mined" (R. 216). They "sold none of the coal to any-

one other than Paragon and were not entitled to do so" (R. 216). "If Paragon was unable to take all of the contractors' coal * * * the Contractor would fill his own bins and then shut down until Paragon could take more of his coal" (R. 216). "During the years here involved, Paragon took all merchantable coal produced by the various contractors operating on Paragon's leased property and paid the contractors the price fixed by Paragon" (R. 216). "While there is some evidence that the amount paid by Paragon fluctuated somewhat with extended changes in the market price of coal and changes in labor costs, there is no evidence that the amount paid by Paragon was directly related either to the price it was getting for the coal or to the sales price of a particular contractor's coal, and the amount was apparently changeable at the will of Paragon" (R. 222).

The record evidence that Paragon had the power to set the price the miners would receive for any and all coal they mined is overwhelming and, unlike the evidence as to terminability, wholly uncontradicted. See R. 56, 86, 87, 90–91, 93, 105, 119, 141–144, 185–186; see also R. 49–50, 64–65, 114, 136, 147, 170, 180. There is absolutely no indication that the miners had legally enforceable rights to receive any other amount than that set and reset by Paragon prospectively to induce the performance of mining services. While the Fourth Circuit correctly noted that "it was understood that the price would, and in fact it did, vary with the market" (R. 254), the record makes it entirely clear that the understanding was primarily a warning to

the miners that their price for mining would have to fall if the market price of coal fell and secondarily an unenforceable assurance by Paragon that, like any forward-looking businessman, it would treat its contractors generously if times improved. Neither the warning nor the assurance casts any doubt on the correctness of the Tax Court's findings that the price paid the miners was "fixed by Paragon" (R. 216) and "was apparently changeable at the will of Paragon" (R. 222).

2. The court of appeals, although holding that the contracts were not terminable at Paragon's will, did not in terms disturb the Tax Court's finding that Paragon was legally free to set the tipple price at whatever level it chose. And on this record, we do not believe it possible to find any legally enforceable standard by which Paragon was bound in setting the price. The lack of an enforceable price standard would in turn make the purported contract right to mine to exhaustion of little substance, since Paragon, by setting the price so low as to be noncompensatory, could effectively force the contract miners to exercise *their* right to terminate the contracts.[4] In view of the intimate relationship between the power to terminate a contract and the power unilaterally to change

[4] That would not, however, make the nonterminability of the contracts entirely illusory. A termination right would permit Paragon to terminate a single contract and not others. Assuming nonterminability, however, Paragon was surely required, at a minimum, to offer the same tipple price to all its contractors, and thus could not use its control over the tipple price to force a single contractor to quit work.

the price at which it is to be performed, the court's evident inability to find an enforceable price standard casts additional doubt on its finding that the contracts were intended to be terminable only by the miners and not by Paragon.

Another way of resolving the anomaly, while respecting the finding of nonterminability, would be to find an implied undertaking by Paragon to set the tipple price, at least if market conditions permitted it, at a level that would permit the miners to earn a fair return for their services. At most, however, Paragon would be obligated to pay only the reasonable value of the contractors' services. What is reasonable compensation for services would in turn vary not only with changes in labor costs in the area but also, to a degree, with the profitability of the business. In a limited sense, therefore, such an obligation would give the miners, in the court of appeals' words, a right "to be paid [for the coal mined] at a price which was closely related to the market price" (R. 255).[5] But even if Paragon was legally obligated to set the tipple price at a level that would fairly compensate the miners for their services, it was plainly still paying only for services and not for the right to own and

[5] In fact, we do not believe the court of appeals purported to find a legally enforceable price standard. All it seems to have meant by the quoted phrase was that the miners had a right to be paid the price posted by Paragon and that the posted price was *in fact* "closely related to the market price." Whether the relationship of the tipple price to the market price for coal was the product merely of economic forces or of legal compulsion seems not to have been a matter of concern to the court of appeals.

sell the unmined mineral deposit. If the contract miners demanded an amount in excess of the fair value of their services, Paragon remained free to refuse and to substitute another contractor, thus retaining for itself the full value of the unmined mineral deposit.

In short, the contract miners had no right to share in the value of the unmined mineral deposit; at most they had a right to payment for their services. And without a right to share in the value of the deposit, the miners had no depletable capital or economic interest in the mineral in place.

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed both in No. 134 and in No. 237. If, however, the judgment in No. 237 is affirmed, the judgment in No. 134 should also be affirmed.

Respectfully submitted.

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